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¶1. (U) Sensitive but unclassified. Not for public Internet.

¶2. (SBU) SUMMARY: On February 22, ConocoPhillips' John Dabbar called on the Ambassador to discuss relations between the Kashagan consortium and national oil company KazMunaiGas (KMG), expansion of the Caspian Pipeline Consortium (CPC) pipeline, and the role of international oil companies (IOC) in the Kazakhstan Caspian Transportation System (KCTS). Dabbar also discussed ConocoPhillips' plans in Turkmenistan, the impact of China's energy investments in Central Asia, and the investment climate in Kazakhstan. END SUMMARY.

KMG TAKES CONTROL

¶3. (SBU) John Dabbar (please protect throughout) is the head of oil and gas transportation for ConocoPhillips Russia. He was commercial director of the CPC pipeline in 1996, and currently serves on the Board of Directors of the Baku-Tbilisi-Ceyhan (BTC) pipeline consortium. He told the Ambassador that Conoco's biggest challenge in Kazakhstan in the near term is responding to KMG's "renewed interest in gaining control over Kazakhstan's oil export routes."

LEARNING LESSONS FROM TRANSNEFT

¶4. (SBU) Dabbar said that KMG or one of its affiliates controls every transportation and storage option -- including railways, pipelines, storage tanks, and tanker fleets -- and takes advantage of every minor transaction to extract maximum value from the IOCs. In this manner, Dabbar said, the government can control the price and accessibility of oil export routes. "TK (Timur Kulibayev, President Nazarbayev's billionaire son-in-law) figured this out 15 years ago by watching Transneft's Sergei Yevlakhov operate," Dabbar said. "Now Yevlakhov is suntanned and living large in Monaco." He cited a short, privately-owned rail link in Aktau as a case in point, and said that exports via rail or ship from Aktau must

transit this short rail line, which he said is owned by a small, private company. "I assume TK has an interest in it," he said. Dabbar said that if something like this were to happen in the United States, Conoco could sue under open-access laws, but that is not possible in this region. "In Russia," he said, "everybody in the Ministry of Energy needs a revenue stream and a lever, and sometimes they will pull that lever just to remind you that they can."

DE FACTO VETO

¶5. (SBU) Dabbar also said that KMG Exploration and Production (KMG E&P) generally acts as a commercial equity partner when it votes on multi-year development plans, annual budgets, and individual contracts. However, KMG E&P's parent company, national oil company KMG, acts as the government's authorized agent and effectively exercises veto power over these decisions. Dabbar warned that this could become a "major issue" when the Kashagan consortium votes on plans to implement Phase II of the project.

OPTIMISTIC ABOUT CPC EXPANSION

¶6. (SBU) Although Conoco is not a member of the CPC consortium, it owns 20% of Lukoil, which is a member. Dabbar confirmed that the consortium approved expansion and said that he is more optimistic now than at any time during the past 15 years that capacity of the pipeline will be expanded. Dabbar said that there is one additional "hold point" in October, when the consortium must vote to approve the construction budget, but he does not expect any further difficulties. Dabbar said Conoco welcomes the additional capacity that CPC expansion will provide, since it would free up other transportation routes for oil from Kashagan and the N Block.

KCTS REALITY CHECK

¶7. (SBU) On the Kazakhstan Caspian Transportation System (KCTS), Dabbar said KMG is beginning to understand that the "sweetheart deal" they struck with a consortium of French companies is not going to play out they way they expected (ref A). According to Dabbar, KMG expected to receive free engineering expertise and soft loans, but the French export credit agency has turned out to be as hard-nosed as any commercial bank and has asked for collateral in the form of shipper guarantees before it provides project financing. According to Dabbar, "KMG is slowly beginning to understand that they must treat us as investors and partners, not just paying customers."

LOYALTY PAYS

¶8. (SBU) Under KMG president Kairgeldy Kabyldin, Dabbar said, the government's position has shifted from allowing the IOCs to acquire a minority equity stake in KCTS to insisting on 100% state ownership. Dabbar opined that Kabyldin has always been a strong and consistent advocate for government ownership of all oil transportation infrastructure on the territory of Kazakhstan. "I have known Kabyldin for 15 years," he said, "since he was a mid-level manager at KazTransOil, and he has always been extremely loyal. As a reward, he was named president of KMG and given a nice pension package." Dabbar speculated that powerful members of the Mangistau oblast community -- including Vice Minister for Energy and Mineral Resources Lyazzat Kiinov -- have a vested interest in maintaining 100% state ownership of the $3 billion KCTS project, perhaps so they can benefit from investments in land and infrastructure.

MAJOR STEP FORWARD

¶9. (SBU) Dabbar said that the IOCs took a "major step forward" in the last four to six weeks, when they were invited to act as technical advisors to KMG and the State Oil Company of the Azerbaijan Republic (SOCAR) for KCTS. Previously, he said the IOCs were "stiff-armed" and shut out of the negotiations, and were told the project was strictly a government-to-government affair. Now they have a legitimate reason to be at the table and will be involved in shaping the project. Dabbar said the IOCs can draw upon

previous feasibility studies and have some influence over the design, cost, timing, and sequencing of the project. "This keeps us at the table," he said, "so that when negotiations over financing begin, we'll be right there, ready to engage."

HEALTH, SAFETY, AND ENVIRONMENT

¶10. (SBU) According to Dabbar, the IOCs are more concerned about health, safety, security, and environmental issues than they are about the cost of KCTS. In particular, he noted that the Kashagan partners are concerned that Kazakhstan has not signed all of the protocols of the International Maritime Organization regarding oil-spill response. He added that Kazakhstan is behind Russia and Azerbaijan in this regard. Dabbar said that under ordinary circumstances, Conoco would devote resources and staff to clean up an oil spill if it affected a third country, but said this would be problematic if there were an oil spill in the Caspian Sea that drifted to Iran's northern coast.

MOVING FORWARD IN TURKMENISTAN

¶11. (SBU) Conoco is moving forward with plans to develop Block 19 in Turkmenistan's offshore zone, and will send an expatriate country manager to Ashgabad on March 1. Dabbar said that Conoco remains interested in exploring Turkmenistan's onshore fields, but admitted that the government has made it clear that no onshore fields are on offer. When asked about the likelihood of a trans-Caspian gas pipeline, Dabbar said that a "capital P" pipeline to bring gas from Turkmenistan's major fields such as Dauletebad would be a "political disaster" and would likely encounter resistance from Russia. However, he suggested that Turkmenistan and Azerbaijan could

negotiate a project-specific agreement to construct a pipeline from one offshore block to another and would have better luck with Moscow if the pipeline connected new, rather than existing, fields.

CHINESE INVESTMENTS GOOD FOR KASHAGAN

¶12. (SBU) Dabbar said that Chinese investments in oil transportation in Kazakhstan were "good for Kashagan" since they allow IOCs to sell oil directly to China, and also free up capacity for oil exports westward. In particular, he said that the Eastern Siberia-Pacific Ocean oil pipeline will pull oil away from the Druzhba pipeline to Asia. "Transneft wants more Kazakh oil to meet its annual quota of 15 million tons," he noted.

ATYRAU-SAMARA AN OPTION

¶13. (SBU) When asked about the Atyrau-Samara oil pipeline, Dabbar said that Conoco considers that a viable export option, despite the lack of a quality bank. He noted that the tariff on the pipeline is low and said it offers a competitive price to shipments by rail, even with the loss in quality. "We're not happy about the lack of a quality guarantee," he observed, "but that's life. It's not a condition precedent. You can't always get everything you want."

KAZAKHSTAN'S INVESTMENT CLIMATE

¶14. (SBU) Commenting on the changing investment climate in Kazakhstan, Dabbar cited an oil industry axiom: "The deal never gets better from the moment you sign the contract. It only gets worse." He said that the government has carefully scrutinized the Kashagan production sharing agreement (PSA), which operates on a cost-recoverable basis. He told the Ambassador that the government recently disallowed $4.5 billion out of a total of $5.3 billion in reimbursement claims. Dabbar said the government claimed the consortium did not submit the requisite documents along with its claim, and said the government claimed that some costs were "more than they should have been" (ref B).

¶15. (SBU) Conoco is concerned about recent statements calling into question the tax stability clauses of existing PSAs (ref C), but Dabbar said he did not believe that Kazakhstan would unilaterally invalidate existing contracts. He said it is more likely that the government will push to renegotiate the terms of contracts to

increase tax and royalty revenue and limit cost recovery, for example. "To be honest," he said, "PSAs are used more frequently in less stable and more hostile environments. PSAs are for Burkina Faso, not Norway. And Kazakhstan wants to be treated more like Norway."

¶16. (SBU) COMMENT: Success in the oil business -- particularly in overseas environments -- requires patience, determination, and a commitment to long-term investments and personal relationships. Despite the obvious difficulties of doing business in Central Asia, ConocoPhillips understands what it takes to succeed in the region and remains optimistic about its ability to recover its sizeable investments in Kashagan and the N Block. END COMMENT.

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